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UNCLAS SECTION 01 OF 02 SANTO DOMINGO 002297

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SENSITIVE

DEPT PASS DOE FOR SECRETARY OF ENERGY SPENCER ABRAHAM FROM
AMBASSADOR HANS HERTELL

E.O. 12958: N/A

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SUBJECT: SCENESETTER FOR SECRETARY OF ENERGY SPENCER
ABRAHAM'S UPCOMING VISIT TO THE DOMINICAN REPUBLIC, APRIL
15 - 16

REF: SANTO DOMINGO 01606

1. (SBU) The Country Team and I look forward to your April 15 visit. The last twelve months has in many aspects been the most difficult time for the country in at least twenty years. Dominicans are distrustful of their politicians and their institutions, are suffering from the prolonged effects of a severe financial adjustment, and are deeply concerned about problems in the electricity sector.

2. (SBU) Dominicans understand that the USG is keenly interested in their plight. On November 21-22 Treasury Under Secretary John Taylor visited for discussions with many

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sectors; in December Assistant Secretary of State for the Western Hemisphere Roger Noriega addressed both houses of the Dominican Congress and undertook similarly wide consultations, discussing the same themes and stressing the need for clean elections, strengthened institutions and judicial prosecution of banking fraud. USTR Amb. Zoellick opened this dialogue further on January 14, stressing the positive perspectives of bilateral and multilateral free trade.

3. (SBU) Your visit will further USG priorities in the sector by sending a message that focuses on key elements:

- - the importance of developing a national plan for a sustainable system;
- - the need to create strong, independent, and capable institutions;
- - respecting the law;
- - the need for impartial treatment and respect for contracts; and, fundamental to all of these,
- - transparency in government.

Political outlook

4. (U) President Hipolito Mejia is strongly pro-United-States. He supported the United States initiative in Iraq, and the Dominican Republic is providing a 300-troop battalion for Iraq reconstruction from August 2003 to August 2004. His government has strongly supported U.S. positions in the UN and other international organizations.

5. (SBU) Mejia is running for re-election in May, 2004. His style is that of a populist gentleman farmer. His campaign started at a great disadvantage at around 20 percent, largely due to inflation and economic discontent, and he has made a slow climb back up through the polls.

5. (U) Remaining well ahead of Mejia is former president (1996-2000) Leonel Fernandez of the Dominican Liberation Party (PLD), on the center left. Fernandez presided during the boom of the 1990,s stimulated by tourism and free zone exports.

6. (U) The USG has donated \$325,000 to fund a team of international observers from the Organization of American States for the elections.

Economy

7. (SBU) The attacks of September 11 and the U.S. economic slow-down directly affected Dominican exports and tourism receipts. Massive bank frauds revealed in early 2003 left the banking system with a gap equivalent to about 15 percent of GDP. The government decided to guarantee all deposits and had to obtain an IMF standby. The standby quickly fell apart when Mejia decided without consultation to incur new debt to buy out Spanish interests in the electricity sector. The standby was not renewed until February 2004.

8. (U) The peso has fallen in value over the last year from

18 to the dollar to about 45. Inflation in 2003 reached about 40 percent, following years of single digits. The Dominican public has proven relatively reserved and resilient in these difficult circumstances.

Electricity Sector

19. (U) The electricity sector of the Dominican Republic is in crisis. The sector has accumulated US \$400 million in arrears. The government's portion of the debt stems from subsidy arrears, stranded costs on renegotiated contracts, and cost associated with the purchase of two distributors. Recent rate adjustments have brought collections and expenditure roughly in line but have not reduced outstanding debt.

110. (U) The sector has a theoretical generation capacity of almost 3000 MW to meet an average daily peak demand of 1600 - 1800 MW. Peak production is running now at around 1000 - 1200 MW.

111. (U) "Keeping the lights on" is vital for the economy and is crucial for President Mejia's re-election prospects.

112. (SBU) Persistent arrears in servicing debt to generator COGENTRIX (owned by Goldman Sachs) almost resulted in a call on sovereign guarantees of \$400 million that would have collapsed the IMF standby and blocked other lending, but the government has managed with great effort to get current on that account.

113. (SBU) U.S.-owned AES is the single largest U.S. investor in the Dominican Republic. It owns a principal generator and is seeking to divest itself of its 50% share in a regional distribution company. Dominican officials have failed to make payments to AES, in contravention to a February sector-wide agreement between the government and operators.

114. (SBU) The World Bank is providing significant interim financing for the electricity sector; the second \$25 million tranche is contingent on the government delivering a chart demonstrating that the first \$30 million was spent exclusively on fuel and paid to the most efficient generators. The government failed to provide this information in the required format, and time-consuming World Bank analysis of its voluminous submission is blocking release of funds.

HERTELL